Anwar et al v. Fairfield Greenwich Limited et al Doc. 218

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UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

ANWAR, et al. v. FAIRFIELD GREENWICH LIMITED, et al.	Master File No. 09 CV 0118 (VM) 09 CV 5012 (VM) (Morning Mist Action) 09 CV 2366 (VM) (Ferber Action) 09 CV 2588 (VM) (Pierce Action)

DERIVATIVE PLAINTIFFS' REPLY MEMORANDUM OF LAW IN FURTHER SUPPORT OF THEIR MOTIONS TO REMAND

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INTRODUCTION

The Court should reject defendant FGA's efforts to transmogrify these derivative cases into "mass actions" under CAFA. FGA argues that jurisdiction here would promote a policy of placing important cases in federal court. In truth, FGA's unprecedented approach would destroy state court jurisdiction over virtually every mid-sized or large case filed by a public company.

Almost all public companies have 100 shareholders (or beneficial owners of shareholders) who could benefit, albeit indirectly, from a company's lawsuit; thus, under FGA's theory, every $5 million contract claim filed by a public company would be a "mass action" removable to federal court. The breadth and impact of FGA's proposed rule are mind-numbing.

Congress, of course, never imagined that CAFA would so open the floodgates of the federal courts -- or slam shut the doors of the state courts. So "drastic a change to federal jurisdiction"[1] was never contemplated by Congress. Fortunately, this radical shift in state court/federal court jurisdiction urged by FGA is not remotely possible under CAFA.

Stripped of its hyperbole, FGA's argument boils down to just two points: (1) a derivative case on behalf of an entity that has 100 investors (or 100 beneficial owners of fewer investors) is a "mass action," and (2) these derivative actions don't relate to internal affairs. The cases must be remanded if FGA is wrong on either point. As shown below, FGA is wrong on both.

ARGUMENT

A. FGA Misstates the Burden of Proof

The Second Circuit squarely places the burden of establishing CAFA jurisdiction on the removing defendant. *Blockbuster*, 472 F.3d at 58; *see also* Dkt. 117 (09 CV 0118), Memorandum Opinion and Order dated May 1, 2009 ("May Order"), at 6 (Katz, M.J.) (citing

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[1] *Cf. Blockbuster, Inc. v. Galeno*, 472 F.3d 53, 58 (2d Cir. 2006) (addressing burden of proof).

Blockbuster). The standard here is proof to a "reasonable probability." *Blockbuster*, 472 F.3d at 58. Disturbingly, FGA denies its burden here.[2] And, its burden cannot be met.

B. FGA Has Not Satisfied the 100-Person Requirement

1. There is Just One Real Party in Interest

FGA cites no authority holding that a derivative action is a "mass action." For good reason. Each derivative case alleges claims on behalf of just one person -- a fund. *Sung v. Wasserstein*, 415 F. Supp. 2d 393, 408 (S.D.N.Y 2006) (Marrero, J.) (remanding derivative lawsuit removed under SLUSA, noting that case was "not a class action"). That there may be over 100 investors in two of the funds (Fairfield Sentry Ltd. and Greenwich Sentry, LP) is beside the point. To qualify as a "mass action," a case must involve "monetary relief claims of 100 or more persons [that] are proposed to be tried jointly …." 28 U.S.C. § 1332(d)(11)(B).[3] *See Lowery v. Alabama Power Co.*, 483 F.3d 1184, 1188 n.7 (11th Cir. 2007) (cited in Opp. at 14) ("mass action" is action "brought by 100 or more persons"). Here, the monetary relief claims in each case are for just one person -- the fund.[4]

FGA concedes that, for purposes of counting, CAFA looks only at the "real parties in interest." Opp. at 11-12, quoting *La. ex rel. Caldwell v. Allstate Ins. Co.*, 536 F.3d 418, 428, 430 (5th Cir. 2008). But in each derivative action, the only real party in interest is the fund, and plaintiffs seek to vindicate the claims of the fund, "somewhat as a 'next friend' may do for an individual ...." *Koster v. Lumbermens Mut. Cas. Co.*, 330 U.S. 518, 522-23 (1947); *see* *Davenport v. Dows*, 85 U.S. 626, 627 (1873) ("The relief asked is on behalf of the corporation, not the individual shareholder, and if it be granted the complainant derives only an incidental benefit from it.").[5]

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[2] Ignoring controlling law, FGA states that "[p]laintiffs cannot prove, *as they must*, that [CAFA's] requirements are not met …." Opposition Brief ("Opp.") at 2 (emphasis supplied).

[3] Subsequent references to CAFA, as codified, omit "28 U.S.C.".

[4] That plaintiffs, *qua* current investors, may benefit from the litigation (albeit indirectly), *see* Opp. at 9, does not suffice to create a mass action. It merely shows that plaintiffs have *standing* to bring derivative actions on behalf of the funds. *See* N.Y. Bus. Corp. Law § 626(b).

The line of cases establishing that the entity -- and not the plaintiff -- is the real party in interest in a derivative action is unbroken. Congress could have changed that rule for CAFA and counted the entity's investors towards the 100-person requirement in derivative cases, but did not do so. Thus, with just one "real party in interest" in each derivative case, FGA fails the CAFA count test by 99.

2. CAFA's Legislative History Undermines FGA's Argument

Suggesting statutory ambiguity, FGA cherry picks from legislative history, especially Senate Report 109-14 ("Report").[6] FGA then improperly seeks to "enshrine the Committee Report as law." *Blockbuster*, 472 F.3d at 58. The Report, however, confirms that Congress merely sought to provide a "narrowly-tailored expansion of federal diversity jurisdiction," *see* Report at 27, and explains that, for a "mass action," there must be 100 "named plaintiffs." *Id.* at 46. CAFA thus "leaves in state court" "class actions with fewer than 100 plaintiffs." *Id.* at 27.

Statements of legislators are in accord. As Representative Jim Sensenbrenner explained:

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[5] *See also Ross v. Bernhard*, 396 U.S. at 538; *Joy v. North*, 692 F.2d 880, 887 (2d Cir. 1982); *Mottolese v. Kaufman*, 176 F.2d 301, 302 (2d Cir. 1949) ("The real plaintiff in interest ... is not the shareholder, but, as in all shareholders' derivative suits, the [company]"); *Bankston v. Burch*, 27 F.3d 164, 167 (5th Cir. 1994) ("the partnership is ... the real party in interest in a derivative lawsuit").

[6] *See Exxon Mobil Corp. v. Allapattah Servs., Inc.*, 545 U.S. 546, 568 (2005) ("Judicial investigation of legislative history has a tendency to become, to borrow Judge Leventhal's memorable phrase, an exercise in '"looking over a crowd and picking out your friends."'") (quoting Wald, *Some Observations on the Use of Legislative History in the 1981 Supreme Court Term*, 68 Iowa L. Rev. 195, 214 (1983)).

> Under subsection 1332(d)(11), any civil action in which *100 or more named parties* seek to try their claims for monetary relief together will be treated as a class action for jurisdictional purposes. *The Sponsors wish to stress that a complaint in which 100 or more plaintiffs are named* fits the criteria of seeking to try their claims together, because there would be no other apparent reason to include all of those claimants in a single action unless the intent was to secure a joint trial of the claims asserted in the action.

151 Cong. Rec. H723, H729 (daily ed. Feb. 17, 2005) (emphasis added). *See also* 151 Cong. Rec. S1076, S1082 (daily ed. Feb. 8, 2005) (statement of Sen. Lott).

The legislative history further reveals that the 100 or more "named" plaintiffs must be seeking to try "their claims" for monetary relief. Report at 46 ("100 or more named parties [must] seek to try *their claims* for monetary relief together") (emphasis supplied); *id.* at 47 ("mass actions" involve "a lot of people who want *their claims* adjudicated together") (emphasis supplied); *see also* statements of Rep. Sensenbrenner and Sen. Lott (cited above). Here, of course, none of the derivative cases has more than two named plaintiffs; moreover, the cases do not seek to vindicate "their" claims, only those of the real parties in interest -- the funds.[7]

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[7] FGA's public policy arguments add nothing to the mix. Although CAFA "creat[ed] another basis to remove 'securities cases that have national impact' from state courts," Opp. at 5 (quoting *Estate of Pew v. Cardarelli*, 527 F.3d 25, 26 (2d Cir. 2006)), the derivative cases are not securities cases. Moreover, a key concern underlying CAFA was that certain state court judges were too "lax" in applying the "strict requirements" of class certification. Report at 14. But in these derivative cases, no class certification is sought.

Nothing about these derivative actions "resemble" class actions. Opp. at 6. Indeed, the distinction between derivative and class actions is so well recognized that courts routinely prohibit class counsel from asserting derivative claims. *See, e.g., St. Clair Shores Gen. Employees Ret. Sys. v. Eibeler*, No. 06 CV 688, 2006 U.S. Dist. LEXIS 72316, at *23 (S.D.N.Y. Oct. 4, 2006) ("Courts in this Circuit have long found that plaintiffs attempting to advance derivative and direct claims in the same action face an impermissible conflict of interest."); *Brickman v. Tyco Toys, Inc.*, 731 F. Supp. 101, 109 (S.D.N.Y. 1990) (denying class certification motion: plaintiff "cannot maintain that suit and his derivative action simultaneously").

3. FGA's Discovery in *Pierce* is Inadmissible and Non-Probative

FGA's argument in the *Pierce* case is misguided. Conceding there are just 29 current investors in the Greenwich Sentry Partners, LP fund ("GSP"), FGA claims there are 111 beneficial owners of the current investors in FGA.[8] But a beneficial owner of a person who, in turn, is an investor in a fund is not even a "next friend" of the real party in interest, *see Koster*, 330 U.S. at 522-23; it's a distant relative. As shown above, the number of investors in the fund is irrelevant for purposes of CAFA jurisdiction in a derivative action. FGA's suggestion that the Court should jump through another hoop and count the number of beneficial owners of the persons who in turn invested in the fund, is nonsensical.[9]

Also, CAFA makes no mention of "beneficial owners." If Congress wanted them to count for the 100-person test, it would have said so. *Compare with* 15 U.S.C. § 80a-3(c)(7)(B)(i) (exempting from definition of "investment company" an issuer whose securities "are beneficially owned by not more than 100 persons"); 15 U.S.C. § 78p(a)(1) (requiring disclosure by person who is "directly or indirectly the beneficial owner" of certain securities).

Not only is FGA's legal argument specious, its factual analysis suffers from the same defect that plagued Michael Thorne's declaration. In granting FGA's application for jurisdictional discovery, the Court stated:

> [W]here jurisdictional facts are placed in dispute, the court has the power and obligation to decide issues of fact by reference to *evidence* outside the pleadings, such as *affidavits*.

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[8] Amended Declaration of Paul J. Sirkis, dated July 31, 2009 ("Am. Sirkis Decl."), ¶¶ 2, 12.

[9] Citing an absence of "controlling authority," FGA claims it removed the cases in good faith and thus should not have to pay costs and fees under 28 U.S.C. § 1447(c). Opp. at 9 n.8. But the test is whether removal was "objectively reasonable," *Martin v. Franklin Capital Corp.*, 546 U.S. 132, 141 (2005), not whether it is precluded by controlling authority. Here, removal was unreasonable.

May Order at 4 (emphasis supplied) (citation omitted). *See also* Letter of Mark Cunha, Esq. to Judge Katz, dated Apr. 16, 2009 ("Cunha Ltr."), at 3.

Virtually all of the materials submitted by FGA to satisfy the 100-person test (as wrongly construed by FGA) are letters or emails, and thus rank hearsay. Hearsay doesn't suffice. *Cunningham Charter Corp. v. Learjet, Inc.*, No. 07 CV 233, 2008 U.S. Dist. LEXIS 61709, at *12 n.3, 14-15 (S.D. Ill. Aug. 13, 2008) (CAFA case); *see generally Zhen Nan Lin v. U.S. Dep't of Justice*, 459 F.3d 255, 272 (2d Cir. 2006); *Wahad v. FBI*, 179 F.R.D. 429, 435 (S.D.N.Y. 1998) (striking portions of lawyer's affidavit "fraught with … inadmissible hearsay").

[redacted][10] [redacted]

[redacted]

[10] As shown above, what matters here is that there is only *one* real party in interest (the fund); the number of the fund's limited partners (or those partners' beneficial owners) is irrelevant.

[11] [redacted]

[redacted]

FGA's count also includes people who died before the start of the lawsuit, further overstating the number of current beneficial owners. *See* 8/21/09 Aff. of Frank E. Pierce.

[redacted]

C. **Plaintiffs Do Not Seek "Monetary Relief"**

Because plaintiffs are suing derivatively on behalf of the funds, they are seeking equitable relief, not "monetary relief" as required by CAFA. § 1332(d)(11)(B)(i). *See Ross*, 396 U.S. at 538; *Koster*, 330 U.S. at 522. That fact defeats a "mass action."

[12] Even assuming, contrary to the law, that the number of current beneficial owners of the limited partners of the fund were relevant, the number of former beneficial owners is not. *See* N.Y. Bus. Corp. Law § 626(b) (plaintiff in derivative action must have current ownership interest).

[13] [redacted]

D. CAFA's "Internal Affairs" Provision Precludes Jurisdiction

Jurisdiction also is precluded by CAFA's "internal affairs" provision, § 1332(d)(9)(B).[14] FGA does not dispute that the cases (at least principally) concern the funds' internal affairs or governance; nonetheless, FGA argues that the cases relate to "improper marketing and promotion." Opp. at 16 (citing *Puglisi v. Citigroup Alternatives Inv., LLC*, No. 08 CV 9774, 2009 WL 1515071 (S.D.N.Y. May 29, 2009)). The argument is without merit.

As derivative actions, these cases relate to the funds' "internal affairs or governance," and *Puglisi* does not suggest otherwise. *Puglisi* quotes at length allegations of improper marketing and promotion from the complaint in that case. *Id.* at *2-3. Here, FGA points to no comparable allegations in the derivative complaints. The *Puglisi* complaint also pled class action claims and asserted that class members "suffered damages" that they could have avoided by

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[14] Principally relying on *Brook v. UnitedHealth Group Inc.*, 2007 WL 2827808 (S.D.N.Y. Sept. 27, 2007), FGA says plaintiffs bear the burden to prove "exceptions" to CAFA jurisdiction. Opp. at 13 n.12. *Brook*, however, listed only three "exceptions": the so-called "local controversy," "home state controversy" and "interests of justice" exceptions. *See* 2007 WL 2827808, at *3 & nn.5-7. CAFA's "internal affairs" provision is not among those "exceptions." None of FGA's other cases (Opp. at 13 n.12) addressed the placement of the burden with respect to the "internal affairs" provision.

Moreover, the three exceptions described in *Brook* concerned scenarios in which a court may or shall "decline to exercise jurisdiction" under CAFA. *E.g., Serrano v. 180 Connect, Inc.*, 478 F.3d 1018, 1023 (9th Cir. 2007) ("§§ 1332(d)(4)(A) and (B) *require* federal courts -- although they *have* jurisdiction under § 1332(d)(2) -- to '*decline to exercise jurisdiction*' when the criteria set forth in those provisions are met.") (emphasis in original) (cited in Opp. at 13 n.12). In contrast, the internal affairs provision, § 1332(d)(9)(B), provides that jurisdiction "shall not apply" in a case relating to internal affairs. *See generally Estate of Pew*, 527 F.3d at 30 & n.2 (actions relating to internal affairs are "excluded from CAFA's expanded jurisdiction"). Thus, in a case related to internal affairs, jurisdiction never even attaches in the first place. Accordingly, even if a plaintiff bears the burden to prove CAFA's "exceptions" under *Brook*, that burden does not extend to cases related to internal affairs.

"withdrawing their funds from the Fund."[15] Here, plaintiffs assert derivative claims and allege damages to the *funds*, thus placing the cases squarely within CAFA's "internal affairs" provision.

FGA's reliance on *In re American Int'l Group, Inc.*, 965 A.2d 763 (Del. Ch. 2009) (Opp. at 17), to contest application of the "internal affairs" provision, backfires. As that case noted, "PWC's role as an auditor *relates to the internal affairs of the corporation* …." *Id.* at 817 (emphasis supplied). CAFA's "internal affairs" provision applies where the claim "relates to the internal affairs … of a corporation," § 1332(d)(9)(B); thus it applies here.[16]

FGA also argues that the internal affairs provision seeks to preserve "the federal versus state court jurisdictional lines already drawn in the securities litigation class action context" by SLUSA. Opp. at 16 (citation omitted). SLUSA, however, does not provide for federal jurisdiction over derivative claims. *Sung*, 415 F. Supp. 2d at 408.

Finally, state court expertise on internal affairs matters (Opp. at 17) supports remand here. *See Matter of Topps Co. Inc. Shareholder Litig.*, 2007 N.Y. Slip Op 52543U, at *6, 19 Misc. 3d 1103A (Sup. Ct. N.Y. County 2007) (New York's Commercial Division is "a specialized commercial court that has been successfully handling complex commercial and corporate litigation since its inception in 1993…. This court is empowered to hear cases involving breach of fiduciary duty claims arising out of corporate restructuring, shareholder derivative actions, and disputes concerning the internal affairs of business organizations …").

[15] *See Puglisi* Complaint, ¶ 70 (Exh. A to Dkt. 1, 08 CV 9774 (S.D.N.Y.)).

[16] *First Nat'l City Bank v. Banco Para el Comercio Exterior de Cuba*, 462 U.S. 611 (1983) (Opp. at 17) is inapposite. That case did not involve CAFA, but rather the availability of a setoff to a claim by a foreign governmental instrumentality. *See id.* at 613.

E. FGA's Hypothesized Joinder Precludes a Mass Action

CAFA excludes from "mass actions" an action in which "the claims are joined upon motion of a defendant." § 1332(d)(11)(B)(ii)(II). Here, the would-be joinder of hypothesized claims of 100 persons (even assuming there were 100 real parties in interest) is a suggestion of defendant FGA, not the plaintiffs. That fact alone precludes a mass action. *Tanoh v. Dow Chem. Co.*, 561 F.3d 945, 954 (9th Cir. 2009).

CONCLUSION

The Derivative Plaintiffs' motions should be granted.

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